P-421, 405, 407, 430, 426, 520, 427/CI-87-76 ORDER ELIMINATING METROPOLITAN TIER RATE STRUCTURE OF U S WEST COMMUNICATIONS INC. AND ESTABLISHING COMMENT PERIOD TO CALCULATE NEW UNIFORM RATE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Darrel L. Peterson	Chair
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner
Don Storm	Commissioner

In the Matter of the Petitions of Certain Subscribers in the Exchanges of Zimmerman, Prescott, Waconia, Belle Plaine, North Branch, Lindstrom, New Prague, Cambridge, Hudson, Houlton, LeSueur, Cannon Falls, Delano, Northfield, Buffalo, and Watertown for Extended Area Service to the Minneapolis/St. Paul Metropolitan Calling Area

ISSUE DATE: December 20, 1991

DOCKET NO. P-421, 405, 407, 430, 426, 520, 427/CI-87-76

ORDER ELIMINATING METROPOLITAN TIER RATE STRUCTURE OF U S WEST COMMUNICATIONS INC. AND ESTABLISHING COMMENT PERIOD TO CALCULATE NEW UNIFORM RATE

PROCEDURAL HISTORY

The Commission initiated its inquiry into U S West Communication's (U S West's) metropolitan tier rate design on March 20, 1987, in its initial Order in the Consolidated Metropolitan Extended Area Service (EAS) case. In that Order, the Commission raised the issue of whether the needs of the region were best served by U S West's existing tier rate structure.

On June 20, 1989, the Commission issued another Order in the EAS case. In that Order, the Commission found that the U S West tier system continued to be serviceable and that questions regarding effective alternatives were beyond the scope of the metropolitan EAS proceeding. The Commission directed its staff to review the appropriateness of U S West's metropolitan tier rate design and advise the Commission on the need to initiate a separate proceeding to examine the issue.

The staff report ordered by the Commission was submitted in February 1990. A supplemental staff report was submitted in November 1990 to discuss how U S West's tier rate structure was affected by new EAS legislation enacted April 27, 1990 and the Northwestern Bell Incentive Plan Case.

The Commission met on December 4, 1990 to consider the tier rate design issue. The Commission issued its Order in that proceeding on December 21, 1990. The Order established a comment period and asked parties to identify the legal and policy issues the Commission should consider in determining whether to retain or change the current tier rate design.

In late January 1991, the Department of Public Service (Department), the Suburban Rate Authority (SRA), the Residential Utilities Division of the Attorney General's Office (RUD-OAG) and U S West submitted comments in response to the Commission's December 21, 1990 Order. The SRA and U S West submitted reply comments in early February 1991. The Commission met on May 23, 1991 to consider the comments of the parties. The Department, SRA and RUD-OAG recommended elimination of the tier rate structure; U S West argued for its retention.

On June 18, 1991, the Commission issued its ORDER REQUIRING CERTAIN PARTIES TO FILE INFORMATION CONCERNING THE NEED FOR FURTHER PROCEEDINGS ON THE METROPOLITAN TIER RATE DESIGN OF U S WEST COMMUNICATIONS, INC. In that Order, the Commission instructed the Department, RUD-OAG, SRA and U S West to provide the following:

(1) a summary of the available cost of service data that would be useful in evaluating the current metropolitan tier rate structure;

(2) a description of the additional information or studies, if any, needed to evaluate adequately the current metropolitan rate structure;

(3) an estimate of the cost to U S West of any additional studies needed to evaluate the current tier rate design and an estimate of how long it would take to complete the studies; and

(4) an estimate of the cost to [the parties] of further proceedings to review and consider replacing the metropolitan tier rate system.

The Commission met on November 5, 1991 to consider the comments of the parties.

FINDINGS AND CONCLUSIONS

The tier rate system divides U S West's St. Paul/Minneapolis metropolitan service area into four tiers in concentric rings around the Twin Cities. Rates for local service increase proportionately from the inner tier, Tier I, to the outermost tier, Tier IV. Rates for a one-party residence currently range from $14.16 in Tier I to $17.89 in Tier IV. One-party business rates range from $42.48 in Tier I to $53.67 in Tier IV.

The tier system was instituted in 1979 as a result of U S West's (then Northwestern Bell's) general rate case. The rates were increased in U S West's general rate case in 1980; however, the basic tier design was retained and has remained unchanged since that time.

The rationale for the current metropolitan tier structure rests on two assumptions. The first of these is that the cost of transmitting an interoffice call[1] within the metropolitan area is distance sensitive. This means that the cost to U S West of transporting an interoffice call increases with the distance between the caller and the called party. The second assumption is that the interoffice calls of outer-tier customers travel greater distances than the interoffice calls originating in tiers closer to the center of the metropolitan area. Therefore, presumably, subscribers in Tier IV place a higher financial burden on U S West than those in Tiers I through III. Similarly, the customers in Tier III presumably cost the Company more than subscribers in Tiers I and II. The customers in Tier II would, following the same line of reasoning, cost the Company more than those who live in the first tier.

The Commission finds that the cost assumptions set forth above are no longer valid. Interoffice calling costs in the metropolitan area have fallen dramatically in the last 12 years due to the widespread introduction of fiber optic cable and computerized switching technology. As a result, the cost to U S West of transmitting an interoffice call now bears little relationship to the distance between the caller and called party. The Company has confirmed this, indicating that the cost of interoffice calling no longer differs significantly among the four tiers. Therefore, the original cost basis for U S West's metropolitan tier rate design no longer exists.

The Company has identified a number of non-cost factors as support for retaining the current tier design. Most of these focus on the importance of rate stability. Specifically, U S West argues that any change in rate design would (1) be contrary to the rate-stability goal of its Incentive Plan, and (2) generate a large volume of complaints that would consume significant time and resources of both the Company and the Commission.

The Commission recognizes that rate stability is one of the primary benefits of the Company's Incentive Plan. However, the Incentive Plan was never intended as an absolute bar to any modifications in rate design. The Commission recognized the possibility of rate changes expressly in its March 15, 1990 ORDER

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[1] An interoffice call is a call from a person served by one telephone switching (central) office to a person served by another central office. There are approximately 50 telephone central offices in the Twin Cities metropolitan calling area. An interoffice call first travels from the caller to the caller's central office. It then travels from the caller's central office to the central office serving the called party. Finally, it travels from the called party's central office to the called party. The interoffice usage cost is the cost of transmitting a call from the central office serving the caller to the central office serving the called party.

DETERMINING DISCOVERY MOTION, stating the following with respect to the Incentive Plan:

> Although adopting the plan would preclude the Commission from ordering the Company to initiate a general rate case for the life of the plan, it would not preclude an investigation into individual rates under Minn. Stat. § 237.081, subd. 1a.

The Commission is also aware that any increase in rates resulting from the elimination of the tier structure may create disaffection among some customers and generate complaints. This, however, is not an uncommon consequence of a change in rates. The relevant question is not whether some individuals will react adversely to the change, but whether the change is justified. The change ordered in this proceeding is clearly justified since the current rate structure is no longer supported by acceptable cost data. Rate stability alone is not sufficient to maintain a rate structure that no longer finds support in the rationale for its creation. Retaining the tier system solely to avoid the disruption of a change in rates would suggest that a particular rate design, once adopted, must become a permanent fixture even if the original basis for the rate structure has disappeared. The Commission rejects this notion for obvious reasons.

U S West has offered several other non-cost considerations as support for the current tier structure. Included among these considerations is concern for low income subscribers in St. Paul and Minneapolis whose rates would increase if the tier structure were eliminated. Also included is concern that elimination of the tier structure would exacerbate the disparity between Tier IV customers and Extended Area Service (EAS) subscribers living just beyond the limits of the metropolitan calling area.

The Commission shares the Company's commitment to affordable service, but hastens to point out that low income families in the Twin Cities area do not reside exclusively within the city limits of St. Paul and Minneapolis. Many low income families live in the outer-tiers and they will benefit from the elimination of the tier system. Moreover, there is no evidence in the record to suggest that the small increase in Tier I rates resulting from elimination of the tier structure would place an undue financial hardship on low income subscribers in Tier I. If rates in the metropolitan area are replaced by a uniform rate on a revenue neutral basis, the increase in the monthly rate for residential customers in Tier I will be approximately 50 cents. In contrast, the decrease in the rate for Tier IV subscribers will likely exceed three dollars. The reduction in Tier III rates will probably exceed one dollar. As such, the benefit to outer-tier customers of eliminating the tier system should exceed any harm to their counterparts in the cities.

The Commission understands the Company's reluctance to widen the gulf between outer-tier metropolitan rates and EAS rates. The Commission simply stresses that EAS rates are determined through a distinct statutory process according to a statutorily prescribed formula. The EAS statute is intended as the mechanism for determining EAS rates, not as a basis for setting rates in the metropolitan calling area. Therefore, EAS rates are irrelevant to any consideration of the reasonableness of the metropolitan tier structure. The tier design must stand or fall on its own merit.

The tier structure creates a substantial disparity between the rates of customers in the inner-most tiers and their counterparts in the outer-most tiers.[2] Since the original cost basis for the tier design no longer exists, this disparity is no longer justified. U S West suggests intraoffice facilities costs as justification for the tier design. These are the costs associated with installing and maintaining the equipment (primarily wiring) that transmits calls between subscribers served by the same central office. U S West asserts that these costs are greater in the outer-tiers because the average length of the wire connecting a customer to his or her central office increases in proportion to the distance of the central office from the center of the metropolitan area.

The Commission recognizes that the average length of the wire or "loop" is longer in suburban and rural areas that it is in the urban core of the metropolitan calling area. Loop length, however, is not the sole determinant of intraoffice facilities costs. More important, any differences in these costs have traditionally been spread among all ratepayers and have not been reflected in rates. Instead these costs have been averaged throughout the state. This is part of a long-standing policy to promote universal service and ensure equitable rates among customers within each customer class. The Commission sees no reason to depart from that policy in this proceeding. Absent its original cost basis, the tier system of rates should be eliminated and uniform rates established by customer class throughout the Twin Cities metropolitan area.

ORDER

1. U S West shall replace the current tier rate design in the metropolitan calling area with a uniform rate for residential customers and for business customers by class of service.

2. Within 90 days of the date of this Order, U S West shall calculate and submit its new uniform rates. These new rates must be revenue neutral.

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[2] Currently, a U S West subscriber in tier IV pays 26% more than a tier I customer for the same service.

3. Within 90 days of the date of this Order, U S West, the Suburban Rate Authority, the Department of Public Service, the Residential Utilities Division of the Attorney General's Office and other interested parties shall submit comments regarding the form and scope of the notice that must be given before implementing the new uniform rates.

4. All parties shall have 30 days from the date of the Company's filing to file comments on the proposed rates.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)